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EXECUTIVE SECRETARIAT

Routing Slip

TO:		ACTION	INFO	DATE	INITIAL
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Remarks:

[Signature]
Executive Secretary
8/18/83
Date

CABINET AFFAIRS STAFFING MEMORANDUM

Executive Registry

83-4146

DATE: 8/15/83 NUMBER: DUE BY:

SUBJECT: Cabinet Council on Economic Affairs - Minutes

83 AUG 17 P 4: 21

	ACTION	FYI		ACTION	FYI
ALL CABINET MEMBERS	<input type="checkbox"/>	<input checked="" type="checkbox"/>	Baker	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Vice President	<input type="checkbox"/>	<input type="checkbox"/>	Deaver	<input type="checkbox"/>	<input type="checkbox"/>
State	<input type="checkbox"/>	<input type="checkbox"/>	Clark	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Treasury	<input type="checkbox"/>	<input type="checkbox"/>	Darman (For WH Staffing)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Defense	<input type="checkbox"/>	<input type="checkbox"/>	Harper	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Attorney General	<input type="checkbox"/>	<input type="checkbox"/>	Jenkins	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Interior	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Agriculture	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Commerce	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Labor	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
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HUD	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Transportation	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Energy	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Education	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Counsellor	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
OMB	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
CIA	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
UN	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
USTR	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
CEA	<input type="checkbox"/>	<input checked="" type="checkbox"/>	CCCT/Gunn	<input type="checkbox"/>	<input checked="" type="checkbox"/>
CEQ	<input type="checkbox"/>	<input type="checkbox"/>	CCEA/Porter	<input type="checkbox"/>	<input checked="" type="checkbox"/>
OSTP	<input type="checkbox"/>	<input type="checkbox"/>	CCFA/Boggs	<input type="checkbox"/>	<input checked="" type="checkbox"/>
	<input type="checkbox"/>	<input type="checkbox"/>	CCHR/Carleson	<input type="checkbox"/>	<input checked="" type="checkbox"/>
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	<input type="checkbox"/>	<input type="checkbox"/>	CCMA/Bledsoe	<input type="checkbox"/>	<input checked="" type="checkbox"/>
	<input type="checkbox"/>	<input type="checkbox"/>	CCNRE/Boggs	<input type="checkbox"/>	<input type="checkbox"/>

REMARKS: Attached for your information are the following CCEA Minutes:

July 26
 July 28
 August 2

RETURN TO:

☐ Craig L. Fuller
 Assistant to the President
 for Cabinet Affairs
 456-2823

☒ Tom Gibson
 Associate Director
 Cabinet Affairs
 456-2800

DCI
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MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

July 26, 1983
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Baldrige, Block, Brock, Donovan, Hodel, Stockman, Feldstein, Harper, Porter, Ahalt, Bailey, Boggs, Chapoton, Khedouri, Leland, McCormack, Baroody, Cicconi, Gibson, Herbolzheimer, Leonard, Nelson, Vipond and McAllister; Ms. Dunlop and Ms. Risque.

1. U.S. and EC Agricultural Policy Differences

Assistant Secretary Ahalt reviewed a paper prepared by the Department of Agriculture. He suggested that among the reasons for the recent slowdown in agricultural trade are the world recession and the serious debt problems of several developing nations. The U.S. has responded to the slowdown by adjusting production and building up stocks. U.S. commodity prices have fallen by one-quarter, farm incomes have dropped by one-third, and government expenditures have increased eight-fold since 1980. The European Community (EC) has responded by raising export subsidies sufficiently to prevent a decline in exports or adjustments in farm prices, income and production levels. EC subsidies in 1983 are likely to reach \$9 billion on sales of possibly \$31 billion.

Mr. Ahalt outlined four alternative policies:

1. Resolving the subsidy conflicts through the GATT. He suggested such a course does not offer much promise, and would have a high opportunity cost. USDA estimates that EC subsidies have displaced possibly \$5-6 billion in U.S. farm exports annually since 1980.
2. Pursuing a policy of limited confrontation with the EC through subsidies targeted at various key EC export markets, such as Egyptian flour and Saudi Arabian poultry.
3. Adopting a policy of open confrontation through the large scale subsidization of a broad range of products to all buyers.
4. Modifying U.S. domestic farm programs to permit more competitive pricing of U.S. products. Lower U.S. prices

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would increase exports and raise the cost of EC agricultural subsidies. The EC currently incurs over \$1 billion in wheat subsidy costs.

Mr. Ahalt stated that the Department of Agriculture supports an eclectic approach, involving elements of all four alternatives:

1. Targeting selected EC export markets as an incentive for changes in the EC agricultural export subsidy program.
2. Reducing loan rates to force producers to become more sensitive to changes in the market and permitting U.S. products to be more competitive internationally.
3. Seeking opportunities in the media and public forums to bring the message to European consumers and taxpayers of the cost of the EC common agricultural policy.

Mr. Stockman prefaced his presentation by stating that much of the analysis of the U.S. and EC agricultural market shares competition is incorrectly focused on what is primarily a short-term cyclical problem. The problem is more complicated than the size of the EC export subsidies and is the result of the asymmetry between U.S. and EC agricultural policies.

Mr. Stockman explained that prior to the 1980-83 worldwide wheat glut, EC agricultural trade policies were not a significant barrier to U.S. farm export expansion. The volume of U.S. grain exports grew by 300 percent between 1970 and 1982. Grain exports increased from 40 million metric tons in 1960 to 80 million tons in the mid-1970's to 115 million tons in 1982. Although volatile, U.S. grain exports as a share of world grain exports are rising. He also pointed out that the positive U.S. merchandise and trade balance with the EC over the past decade is attributable to the large U.S. agricultural trade surplus.

He suggested that the 1980-83 wheat glut, which has led to the intense export competition and conflict, is in large measure attributable to the expansion of U.S. wheat production. Between the early 1970's and the early 1980's, U.S. wheat planting grew by over 30 million acres, which exceeds the entire EC wheat production base. U.S. wheat production in 1982 was 54 percent greater than the 1970-79 level; non-U.S. wheat production was only 23 percent above 1970-79 average.

Mr. Stockman stated that the source of the current trade conflict is the asymmetry between U.S. and EC policies. The U.S. policy is to produce and store; the EC policy is to produce and sell. As a result, the U.S. pushes the world

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price of grain up; the EC pushes it down. Over the years 1979-1982, U.S. wheat exports increased by 140 million bushels; stocks increased by 720 million bushels. Over the same period, non-U.S. exports increased by 536 million bushels, with stock increases of only 60 million bushels. The cost to the U.S. of accumulating and storing the wheat was nearly \$8 billion.

Mr. Stockman suggested that U.S. agricultural policy is a hybrid of two competing policy approaches: "the New Deal strain" of high price supports, mandatory acreage/production controls, and government storage; and the "Farm Bureau/free enterprise strain" which stresses low price supports, minimal acreage control and income deficiency payments. Both of these approaches are incorporated in the 1977 and 1981 farm bills, which built in moderate but rising price supports and high target prices for deficiency payments and weakened supply management tools. The government was given an incentive to reduce its own financial exposure by increasing storage. The gap between out-of-pocket expenses and the price support grew from 96 cents in 1979 to \$1.73 in 1983. Over that period U.S. wheat production increased from 2.1 billion bushels to 2.9 billion in 1982 and 2.4 billion in 1983. The acreage base has increased from 69 million acres in 1979 to 91 million acres in 1983.

Mr. Stockman suggested that the most appropriate U.S. policy would be to: (1) drop the U.S. price support to the lowest level under current law (\$3.30) until the farm action expires. Thereafter, keep the price support close to the out-of-pocket costs of production; (2) circumvent "sell high" triggers through PIK release of stocks into the market, until the U.S. carry-over is reduced; and (3) revise the farm act in 1985 to eliminate storage subsidies and "sell high" release triggers, and adopt tighter and more targeted income deficiency payments.

Secretary Block stated that he generally agreed with Mr. Stockman's analysis. He cautioned however that the Council should not assume that the EC subsidies will not have a longer term effect on U.S. shares of international agricultural trade.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

July 28, 1983
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Baldrige, Block, Brock, Donovan, Hodel, Feldstein, Harper, Porter, Angrisani, Boggs, Chapoton, Cogan, Khedouri, McCormack, Ballentine, Cicconi, Gibson, Neal, Platt, Vipond and McAllister, and Ms. Risque.

1. Fringe Benefits

Assistant Secretary Chapoton reported that the Department of the Treasury is scheduled to testify on H.R. 3525, which would statutorily exclude from income most commonly provided non-statutory fringe benefits that are now perceived as nontaxable, on August 1.

He suggested several reasons for the Administration not to support the bill: the current moratorium on Treasury issuing regulations regarding fringe benefits will likely be extended regardless of the Administration's position; and the question of the tax treatment of fringe benefits should be linked to broad based tax reform. He stated that the Treasury supports the provisions of the bill that would prevent cafeteria plans from offering non-statutory fringe benefits.

Several members objected to the Treasury proposal, pointing out that the Cabinet Council expressed its support for H.R. 3525 at the July 19 meeting. H.R. 3525 would prevent the erosion of the tax base by preventing the further expansion of non-statutory nontaxable fringe benefits. Fringe benefits have expanded considerably in recent years.

The Council agreed that Treasury should seek to postpone its testimony and permit the Cabinet Council to review options for meeting Treasury's concerns while supporting the intent of the legislation.

2. Conservation and Renewable Energy Tax Credits

Mr. Porter explained that the Energy Tax Act of 1978 and the Crude Oil Windfall Profit Tax Act of 1980 created a series of energy tax credits to encourage investment in conservation and renewable energy technologies. Many of these credits are scheduled to expire at the end of 1985. In the fiscal year 1983 Budget, the Administration proposed to repeal all

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business energy tax subsidies and to repeal special provisions allowing States and localities to issue tax-exempt industrial development bonds to finance certain energy property. In response to this proposal, both Houses of Congress adopted resolutions supporting the energy tax credits.

This year, bills have been introduced in both Houses to extend many of the credits through 1990, increase the subsidy, and expand their application. The Department of the Treasury has testified twice this year opposing extending the business energy tax credits. The Department of Energy supports a five year extension of the credits which expire in 1985, but not their expansion.

Mr. Chapoton, presenting the case to allow the credits to expire, stated that the original justification for the tax credits is no longer valid. Crude oil prices have been decontrolled and natural gas prices are being decontrolled under the National Gas Policy Act. The credits are no longer needed because most firms confront the true replacement cost of energy and therefore have sufficient incentive to invest in energy conservation and renewable energy sources. He observed that, unlike broad-based tax incentives aimed at investment and capital formation, such as the Accelerated Cost Recovery System, the energy tax credits are directed at specific activities. Because the Treasury must issue regulations distinguishing between applicable activities and those that are not, the credits can be somewhat arbitrary.

He pointed out that if the Administration opposes extending credits, it is unlikely that a broad extension of all of the expiring credits would be enacted. The estimated revenue loss for a current bill that would extend the credits, with little expansion, is roughly \$3 billion over 1984-88.

Secretary Hodel presented the case for extending the tax credits. He stated that the energy policy goal of this Administration is to allow market forces to provide adequate supplies of energy at reasonable prices in a manner that encourages a balanced energy system. The energy tax credits reduce U.S. energy demand and diversify our energy sources.

Secretary Hodel pointed out that the tax credits were an important part of the Administration's justification for reducing Department of Energy spending on renewable energy technologies. President Carter's fiscal year 1982 budget provided \$1.7 billion for conservation and renewables programs, which was reduced to roughly \$800 million after

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Congressional action on President Reagan's budget revisions. He distinguished tax credits from spending programs by pointing out that the credits allow the market to make the choice of whether to invest or not.

Secretary Hodel stressed that the credits have a significant effect on investment decisions. He reported that Southern California Edison has stated that without extension of the tax credits they would lose 1100 MW of projects, including wind, that would be on-line by 1990. He also noted that the United States offers significant R&D and tax benefits to a number of energy sources, including nuclear and oil. He asserted that renewable energy sources offers the greatest potential for a breakthrough, as evidenced by the fact that private sector has increased its investment in renewables R&D, as the Government reduced spending.

The Cabinet Council discussion focused on a number of topics, including the effect of the tax credit on business decisions. Several members, conceding that the credit may affect investment decisions, stated that such decisions misallocate resources because the world price of oil is the market price. Several members of the Council noted a distinction between the theoretical approach and what is legislatively practical.

The Council asked the Executive Secretary to prepare an options paper for review at a future Council meeting.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

August 2, 1983
8:45 a.m.
Roosevelt Room

Attendees: The Vice President, Messrs. Regan, Block, Brock, Feldstein, Porter, Wright, Bailey, Dederick, Ford, Knapp, McCormack, Poole, Sprinkel, Baroody, Gibson, Neal, Rhodes, Vipond, and Li, and Ms. Hesse.

1. Coordinated Intervention in Exchange Rate Markets

Secretary Regan reported that yesterday the U.S., Japan, and West Germany engaged in a coordinated intervention in the exchange rate markets to weaken the dollar and strengthen other currencies. Today, Switzerland and the Netherlands also joined in the intervention. It is a reasonably substantial intervention compared to previous ones. The length and size of this intervention will depend on how the markets respond.

2. Financial Market Developments and Monetary Policy

Mr. Dederick reviewed the historical behavior of interest rates during recoveries. After the 1953-54 recession, recovery persisted despite the continual rise in interest rates after the recession. After the 1957-58 recession, recovery persisted with only an interruption by the steel strike despite rising interest rates. During both the 1969-70 and 1974-75 recessions, the Federal Reserve pursued a monetary policy which accommodated recovery and kept interest rates relatively low. From the end of 1979 to 1982, the Federal Reserve focused on the monetary aggregates and allowed interest rates to fluctuate.

Mr. Dederick suggested that one lesson to draw from this review is that there is no reason to expect that a rise in short-term interest rates necessarily hurts the recovery. The proper policy is to move gradually now so that drastic actions will not be required later.

Mr. Poole presented a paper examining the implications of velocity changes on monetary policy. The most important determinant of the amount of money entities hold is the scale of their transactions. The larger the entities, whether they are individuals, households, or economies, the larger the cash balances they carry.

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Velocity has exhibited several broad regularities in the post-war period:

1. It has increased at an average annual rate of about 3 percent.
2. It has behaved in a procyclical fashion, tending to fall during business cycle contractions and to rise during business expansions. At least part of the explanation of the decline in velocity in 1982 can be attributed to the cyclical downturn.
3. It has been affected by unusual changes in nominal GNP caused by non-monetary factors, e.g., a steel strike.

The unusual decline in velocity in 1982 could be explained by the combination of the unusual deceleration in GNP from 1980-82 and the extremely high rate of money growth over the four quarters of 1982 -- 8.5 percent.

He suggested that there are a variety of monetary policy options given the uncertainty in the interpretation of recent velocity behavior. Given the Administration's Midsession Review assumption of a 10 percent annual growth of nominal GNP over the next two years, we could assume that velocity growth has permanently slowed to a 1 percent rate, has not fundamentally changed and will grow at a 6 percent rate, or has experienced a one-shot change and will resume a 3 percent rate. These different assumptions call for a money growth target of 9 percent, 4 percent, or 7 percent, respectively.

Mr. Sprinkel presented a paper examining the position the Administration should take on the new Federal Reserve monetary growth target. Sustained money growth typically leads to stronger economic growth 6-9 months later. This short-term relationship seems to be holding which implies that the long-term relationship will hold as well if nothing is changed. In the long-term, excessive money growth usually leads with a lag of 18 months to 2 years to higher inflationary expectations, higher interest rates, and downward pressure on the rate of economic growth.

Mr. Sprinkel stated that he thought the new Federal Reserve targets are appropriate. While such targets would imply higher inflation than otherwise, the alternative, a substantial reduction in money growth and a recession before the 1984 election, would be worse. The Federal Reserve should not resist a rise in interest rates, which by themselves will not necessarily damage the recovery.

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The Council discussion focused on the effect that Federal budget deficits have on the recovery. Several members argued that the Administration needs to mount a renewed offensive against Congressional inaction on our budget proposals. There is a broad public perception that the country can afford to wait until 1985 before addressing the problem. Other Council members noted that while the deficits have had an adverse effect on investment, many sectors, for example, high technology and services, have not been crowded out of the capital markets.